

Exercise walk-through

7.1

IGCSE trade and exchange rates

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The method

Method — Worked example

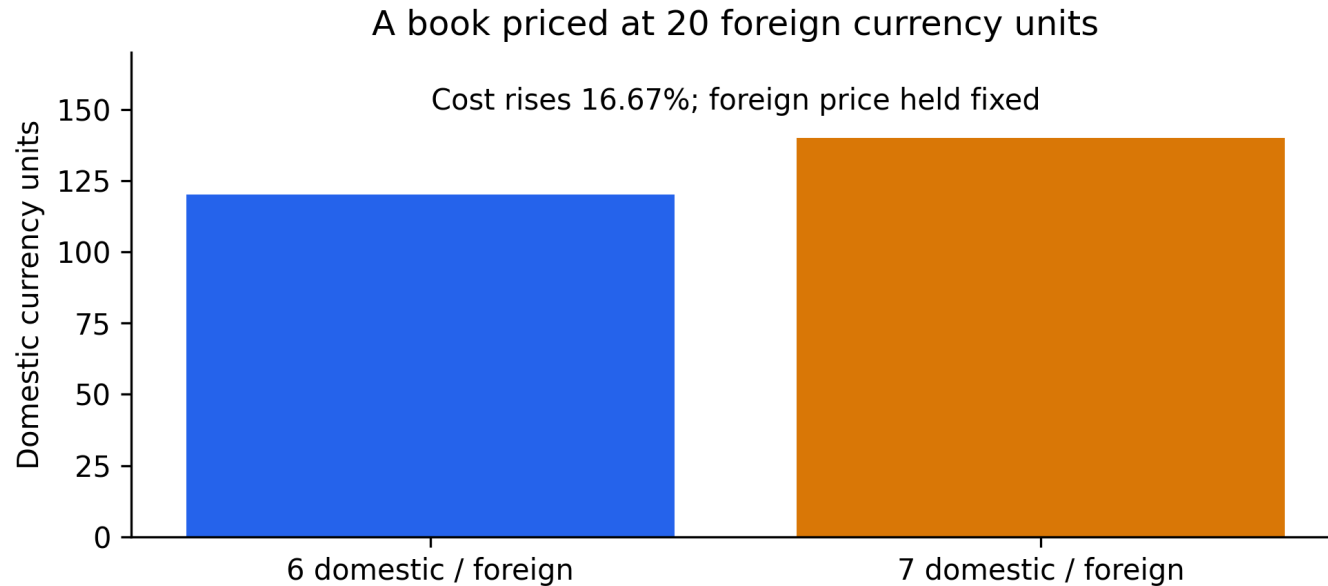
An exchange rate must state currency direction. Trade changes affect consumers, exporters, input users, competing firms and employment differently. Globalization increases integration but does not distribute benefits equally. Protection changes incentives and may provoke retaliation; its justification needs a specified problem and alternatives.

An imported book costs 20 foreign-currency units. The exchange rate changes from 6 to 7 domestic units per foreign unit. Calculate the domestic cost before and after.

Domestic cost = foreign price $\times$ domestic currency per foreign unit. Initially cost = $20 \times 6 = 120$ domestic units; later cost = $20 \times 7 = 140$ domestic units. The domestic currency depreciated in this quotation. Percentage domestic-price change = $(140 - 120) / 120 \times 100\% = 16.67\%$, assuming the foreign price and pass-through are unchanged. Importers pay more; exporters may become cheaper to foreign buyers, but costs, contracts and responsiveness qualify the effect. This is not a current real exchange-rate claim.

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Exercises 2.1·3.1

2.1 For the worked case, state the method, show its application and give a limitation.[3]

3.1 A tariff protects one producer but raises imported component costs for other firms.
Give a balanced judgement and a review condition. [3]

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3.1 A tariff protects one producer but raises imported component costs for other firms. Give a balanced judgement and a review condition. [3]

3.1 Protection can support the targeted producer and revenue but raise input and consumer costs, reduce choice and harm export competitiveness. Consider jobs gained and lost, adjustment time, retaliation, quality and feasible training/competitiveness measures. Recommend only conditionally on evidence about the stated objective and net effects; set a review of prices, quantities, employment and distribution. Do not count all domestic firms as beneficiaries. Authored points for judgement, case-linked reasoning and justified qualification. Accept supported alternatives.